Supreme Court, U.S.
FILED
DEC 24 1997
CLERK

No. 97-868

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

NACCO INDUSTRIES, INC.,
Petitioner,

v.

ROGER W. TRACY, TAX COMMISSIONER OF OHIO,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Ohio

BRIEF OF THE BOND MARKET ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

PAUL SALTZMAN
SARAH M. STARKWEATHER
THE BOND MARKET ASSOCIATION
40 Broad Street
New York, NY 10004-2373

ERIKA W. NIJENHUIS
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, NY 10006-1470

December 24, 1997

CHARLES F. LETTOW
(Counsel of Record)
GIOVANNI P. PREZIOSO
ONNIG H. DOMBALAGIAN
ABBY F. RUDZIN
CLEARY, GOTTLIEB, STEEN & HAMILTON
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006-1801
(202) 974-1500
Counsel for The Bond Market Association as Amicus Curiae

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

24 pp

QUESTIONS PRESENTED *

Ohio's corporate franchise tax taxes gains on the sale of United States Treasury Bonds and other federal obligations, but excludes gains on the sale of comparable state obligations. This case presents the following questions:

1. Whether Ohio's discriminatory tax violates 31 U.S.C. § 3124(a), which bars "each form of taxation that would require the [United States] obligation, the interest on the obligation, or both, to be considered in computing a tax . . . ."

2. Whether Ohio's tax impermissibly discriminates against holders of federal obligations in violation of the intergovernmental tax immunity doctrine under the Supremacy Clause of the United States Constitution.

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* These questions are set out as stated in the petition.

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BRIEF OF THE BOND MARKET ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICUS CURIAE*

The Bond Market Association submits this brief as *amicus curiae* with the consent of the parties as specified in this Court's Rule 37.2(a).[1] The Bond Market Association represents securities firms and banks that underwrite, trade, and sell debt securities in the U.S. and international markets. *Amicus'* members deal in a wide variety of public and private debt securities, including state and municipal obligations as well as those issued by the Department of the Treasury and other entities of the federal government. All of the primary dealers in Treasury obligations, as recognized by the Federal Reserve Bank of New York, are members of the Association, along with

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[1] The written consents of the parties are on file with the Clerk of this Court.

other government securities dealers. From its inception in 1976,[2] the Association has addressed significant government securities issues that confront the industry, fostered sound credit, business, and trading practices for participants in the bond markets, and undertaken initiatives to improve market efficiency. Much of its work regarding federal obligations involves proceedings or actions taken by the Department of the Treasury's Bureau of the Public Debt.

The taxation of both state and federal obligations is of interest to *amicus* insofar as it bears on the effective functioning of markets for those debt obligations. In general, the markets are more efficient with evenhanded, predictable tax treatment of earnings and proceeds from debt securities. This is true for interest income, and it is equally true for gains and losses on dispositions of such securities, whether upon redemption at maturity or upon sale in the secondary market. In this latter respect, a viable, efficient secondary market in debt obligations provides strong support for the primary (new issues) market in such securities. *See* Department of the Treasury, Securities and Exch. Comm'n, and Board of Governors of the Fed. Reserve Sys., *Joint Report on the Government Securities Market* (Jan. 1992) (hereinafter *"Joint Report"*). Investors are more likely to purchase debt obligations if they have assurance that they need not necessarily hold the obligations to maturity but rather may sell them in a secondary market under competitive, efficient conditions.

This case addresses a franchise tax that is not evenhanded and that introduces a tax-based disadvantage into the secondary marketplace for federal debt (Treasury) obligations. Because of the importance of the secondary market in Treasury securities to *amicus* and its members, this brief is submitted to assist the Court in its evaluation of the petition for certiorari.

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[2] *Amicus* was previously named the Public Securities Association.

THE OHIO SUPREME COURT'S DECISION

This case deals with NACCO's investment in a bond issued by the U.S. Treasury, and the gain realized on the sale of that bond in the secondary market. Pet. 4. Under Ohio law, a corporation calculates its net income by including any net gains from the sale of federal obligations but not such gains from the sale of Ohio securities. *See* Pet. 4-5 (discussing Ohio Rev. Code Ann. §§ 5709.76(D) and 5733.04(I)). The Ohio Department of Taxation assessed a corporate franchise tax[3] on the gain from the sale of the Treasury bond, and NACCO appealed, first to the Ohio Board of Tax Appeals and then to the Ohio Supreme Court. Pet. 5-7.

The Ohio Supreme Court upheld the assessment, rejecting NACCO's claims that the taxation of gain on the Treasury bond was barred by 31 U.S.C. § 3124 and the intergovernmental tax immunity doctrine arising from the United States Constitution. Pet. App. 1a, 11a. As to Section 3124, the Ohio Supreme Court acknowledged that the statute operated to exempt federal obligations from state taxation,[4] but the Court held that Section 3124 did not apply to the taxation of a transaction between two private parties in which a Treasury bond was exchanged. Pet. App. 5a. The Ohio Supreme Court also concluded

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[3] Under Ohio Rev. Code Ann. § 5733.06, corporations pay a franchise tax calculated either on a net worth or a net income basis, whichever yields the greater liability. In NACCO's case, the income method resulted in a larger tax payment.

[4] The text of 31 U.S.C. § 3124(a) provides:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. *The exemption applies to each form of taxation that would require the obligation,* the interest on the obligation, or both, *to be considered in computing a tax,* except—(1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and (2) an estate or inheritance tax.

(Emphasis added.)

that the constitutional intergovernmental tax immunity doctrine did not prohibit Ohio's tax. Pet. App. 9a-11a. Although Ohio did not contest that its tax scheme treated gain from sales of federal and state obligations differently, Pet. 7, the Ohio Supreme Court considered that there was insufficient evidence that this "difference in treatment between state and federal obligations affect[ed] or impede[d] a function of the federal government; in this case, the marketability of federal obligations." Pet. App. 10a.

REASONS FOR GRANTING THE WRIT

By taxing gains on the disposition of federal obligations but not its own, Ohio "diminish[es] . . . the investment attractiveness of obligations issued by the United States." *Smith v. Davis*, 323 U.S. 111, 117 (1944). Obligations of the Treasury, which enable the U.S. government to satisfy its borrowing needs, constitute the largest, safest pool of debt instruments available to investors in the world. The size and liquidity of the secondary market in Treasury obligations allow investors to adjust their holdings quickly and conveniently, making the obligations attractive to individual, institutional, and governmental investors worldwide. Discriminatory state taxes, such as the Ohio corporate franchise tax at issue here, that burden this secondary market "in the slightest degree," *id.*, are barred both by the federal statute implementing the intergovernmental tax immunity doctrine, 31 U.S.C. § 3124(a), and by that constitutional doctrine itself.

The Ohio Supreme Court's decision to uphold the Ohio tax against statutory and constitutional challenges stands alone in recent jurisprudence. The decision conflicts with decisions by other state courts invalidating taxes that discriminated against federal debt obligations, *see Doneski v. Comptroller of the Treasury*, 605 A.2d 649 (Md. Ct. Spec. App. 1992) (Maryland income tax), *cert. denied*, 506 U.S. 1054 (1993); *Forbes, Inc. v. Department of Finance*, 487 N.E.2d 251 (N.Y. 1985) (New York City corporation tax), *cert. denied*, 475 U.S. 1109 (1986),

and stands in stark contrast to the tax scheme employed by the great majority of states (with Ohio, Connecticut, and Kansas in the small minority), which either equally tax gains from dispositions of both federal and state obligations, or tax gains from neither one, thus giving even-handed treatment. Certiorari should be granted to resolve the conflict in decisions between the Ohio Supreme Court and the state courts which have disapproved a discriminatory state tax law.

In holding that the federal intergovernmental tax immunity statute, 31 U.S.C. § 3124(a), does not pertain to taxation of gains realized from transactions in the secondary market for Treasury obligations, the Ohio Supreme Court ignored the fact that the statute by its own terms "applies to each form of taxation [requiring] the [federal] obligation . . . to be considered in computing a tax." This statute is "principally a restatement of the constitutional rule" of intergovernmental tax immunity, *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 397 (1983), and "it 'extends to *every form* of [state] taxation . . . [where federal obligations] must *be considered, directly or indirectly, in the computation* of the tax.'" *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 862 (1983) (quoting Rev. Stat. § 3701, 31 U.S.C. § 742, the immediate predecessor of 31 U.S.C. § 3124(a)) (emphasis in original). By contrast, the Ohio Supreme Court concluded that "the transaction subject to the tax does not arise directly from the relationship between the taxpayer and the federal government" but rather "from a contractual relationship between two private parties," Pet. App. 11a, disregarding that it is the appreciation in market value of a Treasury obligation that is being taxed. This Court should grant certiorari to correct the Ohio Supreme Court's interpretation of Section 3124(a) contrary to this Court's precedent.

Decisions of this Court, beginning with *McCulloch v. Maryland*, 4 Wheat (17 U.S.) 316 (1819), and continu-

ing to the present day, teach that the intergovernmental tax immunity doctrine of federal constitutional law, wholly apart from Section 3124(a), bars Ohio from imposing "a state tax . . . on those who deal with the Federal Government" when the tax "is [not] imposed equally on . . . similarly situated constituents of the State." *United States v. County of Fresno*, 429 U.S. 452, 462 (1977). Here Ohio's tax laws impermissibly discriminate in favor of its own state and municipal obligations, and certiorari should be granted to uphold the important constitutional interest.

I. OHIO'S DISCRIMINATORY TAX ON GAIN FROM DISPOSITION OF TREASURY OBLIGATIONS IMPERMISSIBLY DIMINISHES THE INVESTMENT ATTRACTIVENESS OF OBLIGATIONS ISSUED BY THE UNITED STATES

By taxing gains on the disposition of federal debt obligations, but not its own, Ohio burdens the secondary market for federal obligations and thus impermissibly "diminish[es] . . . the investment attractiveness of obligations issued by the United States." *Smith v. Davis*, 323 U.S. at 117.

By issuing Treasury obligations, the U.S. Government secures credit necessary to carry on its functions. The public debt of the United States, as of June 1997, amounted to over $5.37 trillion, approximately $3.43 trillion of which represents marketable securities. *See* Financial Mgmt. Serv., Department of the Treasury, *Treasury Bulletin* at 18-19 (Sept. 1997). In 1996, the Treasury auctioned over $2.4 trillion in marketable securities to the public, both to cover the budget deficit of the United States and to finance maturing debt. Because Treasury obligations are backed by the full faith and credit of the U.S. Government, Treasury obligations constitute the largest, safest pool of marketable debt instruments available to investors in the world.

The depth and liquidity of the secondary market for Treasury obligations substantially enhance the attractiveness of the obligations and ensure that the Treasury may offer them to the primary market at the best possible interest rate, thus minimizing the Treasury's cost of borrowing. The daily volume of secondary market transactions in Treasury securities involving primary dealers averaged approximately $204 billion in 1996. The high volume of secondary market trading ensures that investors are able to adjust their Treasury holdings quickly.[5] To manage the daily volume of trading in Treasury obligations, the U.S. Treasury relies on a well-connected network of primary dealers, nonprimary dealers, and interdealer and retail brokers who make competitive markets in Treasury obligations. *See Joint Report* at A-9 to A-10. As a result of the significant competition, secondary market dealers often charge commissions of as little as 1/32 of one percentage point on transactions in Treasury obligations, thus enabling investors to buy and sell Treasury securities at fair market prices. Because of the high liquidity and price efficiency of the secondary market, Treasury obligations

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[5] In enacting the Government Securities Act of 1986, Pub. L. No. 99-571, 100 Stat. 3208 (codified in scattered sections of 15 U.S.C.), and the Government Securities Act Amendments of 1993, Pub. L. No. 103-202, 107 Stat. 2344 (codified in scattered sections of 15 U.S.C.), Congress recognized the critical importance of the efficiency and liquidity of the secondary market for Treasury securities to the ability of the United States to obtain credit. The Acts, among other things, authorized the Department of the Treasury to promulgate rules and regulations governing brokers and dealers in government securities, *see* Government Securities Act of 1986, title I; Pub. L. No. 99-571, 100 Stat. at 3208-22 (codified at 15 U.S.C. § 78o-5 and in scattered sections of 15 U.S.C.); *see also* Government Securities Act Amendments, § 102, Pub. L. No. 103-202, 107 Stat. at 2345, 15 U.S.C. § 78o-5 (extending the Treasury's rulemaking authority); 17 C.F.R. pts. 400-405 (1997), and to set recordkeeping and reporting requirements for market participants with large positions in particular Treasury issues, *see* Government Securities Act Amendments of 1993, § 104, Pub. L. No. 103-202, 107 Stat. at 2346-48, 15 U.S.C. § 78o-5(f); 17 C.F.R. pt. 420 (1997).

are considered the equivalent of cash for a number of purposes and are widely held by individuals, pension funds, financial institutions, insurance companies, and other institutional investors, as well as foreign and domestic governmental investors.

Ohio, together with other states that discriminatorily tax capital gains on Treasury obligations, burdens the secondary market for Treasury obligations without imposing a like burden with respect to its own obligations. The intergovernmental tax immunity doctrine and the federal statute implementing it, 31 U.S.C. § 3124(a), bar any tax that discriminatorily affects the disposition of Treasury obligations in the secondary market, even "in the slightest degree." *Smith v. Davis*, 323 U.S. at 117. A tax that affected the disposition of a Treasury obligation in the secondary market by as little as one basis point (one hundredth of one percent), for example, could, given the high trading volume in Treasury obligations, result in wider spreads and impair the price efficiency and liquidity essential to the smooth operation of the secondary market.[6] A state may not, under the intergovernmental tax immunity doctrine and Section 3124(a), impose such a burden on the ability of the federal government to borrow money without shouldering the same burden with respect to its own borrowing power.

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[6] Investors purchase Treasury obligations for the purpose of deriving a positive return, and any reduction of the prospect for achieving such a return will tend to diminish the price investors are willing to pay for the obligation (and correlatively tend to increase the interest-rate cost to Treasury). A hypothetical increase of one basis point in the interest rate on the Treasury's marketable securities would increase the federal government's cost of borrowing by over $300 million per year.

In this respect, Ohio must believe that taxation of its own obligations would adversely affect the market for those obligations, or it would not have a provision in its State Constitution that bars such taxation. *See* Ohio Const., art. VII, § 2K(D)(4).

II. CERTIORARI SHOULD BE GRANTED TO RESOLVE THE CONFLICT BETWEEN THE DECISION OF THE OHIO SUPREME COURT TO UPHOLD THIS TAX AND DECISIONS BY OTHER STATE COURTS INVALIDATING SIMILAR TAXES

In upholding the Ohio statute taxing gains from the sale of federal debt obligations without taxing gains from the sale of Ohio obligations, the Ohio Supreme Court stands alone. Five years ago the Maryland Court of Special Appeals invalidated an equally discriminatory tax assessed by the State of Maryland on gains from the sale of federal obligations, concluding that "Maryland's taxation scheme . . . impermissibly discriminates against holders of federal obligations by diminishing the investment attractiveness of the United States obligations in favor of state obligations." *Doneski*, 605 A.2d at 653. The court in *Doneski* addressed the legality of a system under which Maryland never taxed the gain from the sale of its own obligations, while it taxed the gain realized from selling a federal obligation whenever the federal government did. After thoroughly reviewing the history of the intergovernmental tax immunity doctrine and Section 3124, the Maryland court opined that by rendering federal obligations less attractive to investors, Maryland was "increasing the cost and decreasing the value of [borrowed] funds to the federal government. Thus, [Maryland's] tax structure adversely affects the ability of the federal government to raise money and thereby violates the purpose of § 3124." *Id.* at 655 (citation omitted).

Although the tax at issue in *Doneski* was an individual income tax, as contrasted to the corporate franchise tax at issue here, the distinction does not affect the result. The Ohio Supreme Court, however, reached the opposite conclusion without citing *Doneski*.[7] The decisions are in direct conflict.

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[7] The Ohio Supreme Court could not have effectively distinguished *Doneski*, even if it had tried. The Ohio franchise tax is essentially

Also prior to the decision of the Ohio Supreme Court at issue, the Court of Appeals of New York had struck down a tax scheme that disadvantaged investors in federal obligations. In *Forbes, Inc. v. Department of Finance*, 487 N.E.2d 251, the court considered the New York City General Corporations Tax, which employed a formula that treated federal obligations differently from other investments. The court explained that "the City tax unquestionably imposes a greater burden on holders of Federal obligations than on holders of certain other obligations, and thereby diminishes to some degree the investment attractiveness of Federal obligations." *Id.* at 256. After surveying the history of Section 3124(a), the court held the tax system to be impermissible because "the statutory goal of preserving Federal borrowing power is threatened whenever any other class of obligations is taxed more leniently than Federal obligations." *Id.* at 257. This decision by New York State's highest court also directly conflicts with that of the Ohio Supreme Court.

Previously at least one state revenue department expressly recognized that a tax such as that imposed by Ohio would be illegal. *See* Pennsylvania Dep't of Revenue Tax Update No. 16, at 4 (July 1987) ("Ask Revenue" column):

> Q: Is the gain on the sale of Federal obligations exempt for Pennsylvania corporate net income tax purposes?
>
> A: Yes. Since the *C.C. Collings* case requires the Department to exclude from taxable income gains derived from the sale of Pennsylvania state and municipal obligations, the Department is constitutionally obligated to exclude from taxable income the

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an income tax, based as it is on the corporation's net income. *See* Pet. 4; Pet. App. 2a. Additionally, although Section 3124 contains an exception for "a nondiscriminatory franchise tax," the State has not contended that Ohio's corporate franchise tax falls within this exception.

> gains derived from the sale of Federal obligations. This position is consistent with the Department's position of excluding interest on Federal obligations from taxable income. The exclusions of gains derived from the sale of Federal obligations is also consistent with the Pennsylvania Supreme Court's holding in *Commonwealth v. Curtis Publishing Co.*, 363 Pa. 299, 69 A.2d 410 (1949).

Also, a Michigan statute by its own terms provides that the State is "prohibited by law" from subjecting gains and losses on the sale or exchange of federal obligations to the State's income tax:

> "Taxable income" means . . . adjusted gross income as defined in the internal revenue code subject to the following adjustments
>
> . . . .
>
> (c) Add losses on the sale or exchange of obligations of the United States government, the income of which this state is prohibited from subjecting to a net income tax, to the extent that the loss has been deducted in arriving at adjusted gross income.
>
> (d) Deduct, to the extent included in adjusted gross income, income derived from obligations, or the sale or exchange of obligations, of the United States government that this state is prohibited by law from subjecting to a net income tax, reduced by any interest on indebtedness incurred in carrying the obligations and by any expenses incurred in the production of that income to the extent that the expenses, including amortizable bond premiums, were deducted in arriving at adjusted gross income.

Mich. Comp. Laws § 206.30(1).

To date, very few states have tried to do what Ohio has done here: favor their own state bonds over obligations issued by the federal government. Currently, Kansas and Connecticut (in addition to Ohio) tax gains on dispositions of federal obligations while not taxing gains on

their own obligations.[8] Certiorari should be granted to resolve this conflict now, so states can be properly guided in choosing their tax structures.

III. CERTIORARI SHOULD BE GRANTED TO CORRECT THE OHIO SUPREME COURT'S MISINTERPRETATION OF SECTION 3124 AND MISAPPLICATION OF THIS COURT'S PRECEDENTS CONSTRUING THAT STATUTE

Section 3124(a) in one form or another has been in place since the Civil War and is considered "principally a restatement of the constitutional rule." *Memphis Bank & Trust Co.*, 459 U.S. at 397 (citing *New Jersey Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665, 672 (1950); *Missouri ex rel. Missouri Ins. Co. v. Gehner*, 281 U.S. 313, 321-22 (1930)). The statute "establishe[s] Congressional intent to prevent taxes which diminish in the slightest degree the market value or the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Smith v. Davis*, 323 U.S. at 117. In 1959, to thwart attempts by a few states to use a back-door method to tax federal obligations, Congress added a second sentence to the original statute: "This exemption extends to every form

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[8] Several other states tax gains and income on federal obligations to the extent that such taxation is consistent with the U.S. Constitution and their state constitutions. *E.g.*, Kentucky's definition of "[a]djusted gross income" for state tax purposes "[e]xclude[s] income that is exempt from state taxation by the Kentucky Constitution and the Constitution and statutory laws of the United States and Kentucky." Ky. Rev. Stat. Ann. § 141.010(10)(a). Similarly, for its own taxation Oklahoma adapts the amount of federal adjusted gross income by "deduct[ing] amounts included in such income that the state is prohibited from taxing because of the provisions of the Federal Constitution, the State Constitution, federal laws or laws of Oklahoma." Okla. Stat. tit. 68, § 2358.A.2. The disposition of this case, and, indeed, the petition for certiorari itself, may affect the position of these other states respecting the coverage of their tax laws.

of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except— nondiscriminatory franchise . . . taxes . . . ." Pub. L. 86-346, § 105(a), 73 Stat. 621. The Senate Report to the bill that became law explains that the added sentence "makes it clear that the exemption for Federal obligations extends to every form of taxation that would require . . . the obligation . . . to be considered directly or indirectly in the computation of the tax, except nondiscriminatory franchise taxes . . . ." S. Rep. No. 86-090, at 5-6 (1959), *reprinted in* 1959 U.S.C.C.A.N. 2769, 2773-74.

In "reject[ing] and set[ting] aside" the "rather formalistic pre-1959 approach to § 3701," Congress created a "sweeping" exemption for federal obligations. *American Bank & Trust Co.*, 463 U.S. at 862. The Court in *American Bank & Trust* explained that the sentence added in 1959 makes clear that a tax "is barred regardless of its *form* if federal obligations must be considered, either directly or indirectly, in *computing* the tax." *Id.* (emphasis in original). In *American Bank & Trust*, the Court struck down a Texas bank tax computed by including the value of the federal obligations held by the banks. 463 U.S. at 860. Earlier that same Term, in *Memphis Bank & Trust*, the Court struck down a Tennessee bank tax on "net earnings" where "net earnings" was defined to include income on federal obligations but exclude income on Tennessee obligations. 459 U.S. at 393.

As this Court explained in *Nebraska Dep't of Revenue v. Loewenstein*, 513 U.S. 123, 128-29 (1994) (quoting *American Bank & Trust Co.*, 463 U.S. at 862), "[t]he obligation itself is 'considered' [in the computation of tax] when its value is 'taken into account, or included in the accounting.'"[9] The Ohio Supreme Court, however, did

[9] *Loewenstein* addressed repurchase agreements in which credit was extended with federal obligations used as collateral. Interest

not address whether taxing the gain from the sale of a federal obligation required the taxpayer to take the "value" of that obligation "into account." Instead the court limited its inquiry to whether the word "gain" is included in the text of the exemption. *See* Pet. App. 4a ("By its terms, the immunity expressed in Section 3124(a) does not extend to gains from the sale of federal obligations."). This Court's prior interpretations of Section 3124(a), however, dictate a different approach.

As the predicate for its focus on the absence of the word "gain" in Section 3124(a), the Ohio Supreme Court looked to the language of Section 3124(b), which speaks to "the tax treatment of gain and loss from the disposition of [federal] obligations." In so doing, the Ohio Supreme Court "presumed [that Congress had] act[ed] intentionally and purposely when it include[d the] particular language [regarding gains and losses] in one section of [the] statute but omit[ted] it in another." Pet. App. 4a. The two provisions, however, have very different histories, and have only recently been placed together in the same section of the U.S. Code. No inference from the differing language can be drawn. *See Gozlon-Peretz v. United States*, 498 U.S. 395, 404-05 (1991) (employing this principle where a single enactment contained provisions with differing language).

The constitutional doctrine of intergovernmental tax immunity was solely a matter of this Court's jurisprudence until the Civil War. *See Smith v. Davis*, 323 U.S. at

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was paid on the cash extension of credit. The Court held that Section 3124(a) was not implicated by this extension of credit because the role of the federal obligations was purely as collateral, *see* 513 U.S. at 130-31, and that any other form of "collateral [with] sufficient value and liquidity" would have served as well. *Id.* at 131.

Also in *Loewenstein* the Court was explicit that any "repos" using Nebraska's own state and local obligations as collateral would be treated no differently than where federal obligations were so used. *See* 513 U.S. at 135-36.

114-15. When Congress passed the Act of Feb. 25, 1862, ch. 33, 12 Stat. 345, the doctrine also became embodied in a federal statute. That statute and six other statutes were first combined into Section 3701 of the Revised Statutes and then recodified in 1925 as 31 U.S.C. § 742, see *Smith v. Davis,* 323 U.S. at 117 & n.7, and the language of that statute remains virtually unchanged as the first sentence of the present Section 3124(a). In contrast, United States obligations were exempt from federal taxes only until 1941, when Congress enacted the Public Debt Act of 1941, removing their federal tax exempt status. That statute, as amended, is the present Section 3124(b). In 1982, these two separate statutory provisions were recodified as subsections (a) and (b) of Section 3124, Pub. L. No. 97-258, § 3124, 96 Stat. 877, 945. The recodification and combination was not intended to change the meaning of either provision. *See Rockford Life Ins. Co. v. Illinois Dep't of Revenue,* 482 U.S. 182, 183 n.1 (1987).

In all events, as the Maryland Court of Special Appeals recognized in *Doneski,* the inclusion of the terms "gain" and "loss" in § 3124(b) "would be necessary only if section (a) prohibits taxing the gain." 605 A.2d at 651. The Ohio Supreme Court did not consider this theory of how the statute should be construed, but instead focused on a "negative pregnant" construction of Section 3124(a). *Field v. Mans,* 516 U.S. 59, 75 (1995). In *Field,* this Court explained that application of this rule of construction should be "limited," noting that "[t]he more apparently deliberate the contrast, the stronger the inference" to be drawn from the absent language. *Id.* Given the divergent histories of the two provisions, there is no evidence supporting a conclusion that the distinction between (a) and (b) was "deliberate" or meaningful in any respect.

In short, the Ohio Supreme Court's decision that Section 3124(a) was not applicable is at odds with this Court's interpretation announced in *Memphis Bank &*

Trust and *American Bank & Trust* of the effect of the 1959 amendment to the statute. There is nothing in the post-1959 history, including the 1982 recodification, that affects this Court's interpretative rulings on the statute. Certiorari should be granted to address the disparity between the Ohio Supreme Court's interpretation of Section 3124(a) and this Court's prior rulings.

IV. THE OHIO SUPREME COURT'S DECISION CONTRAVENES THE INTERGOVERNMENTAL TAX IMMUNITY DOCTRINE OF FEDERAL CONSTITUTIONAL LAW

Certiorari also should be granted because the Ohio Supreme Court decided a question at the heart of the intergovernmental tax immunity doctrine in a way that contravenes decisions of this Court.[10] Beginning with *McCulloch v. Maryland*, 4 Wheat. (17 U.S.) 316, this Court has ruled that a State may not impose taxes directly on the federal government, nor may a State tax someone who holds federal instruments or obligations or who deals with the federal government if that taxation is not "in common with other property of the same description throughout the State." *Id.* at 436. The latter prong of the intergovernmental tax immunity doctrine has been distilled by this Court into an anti-discrimination rule:

> The rule to be derived from this Court's more recent decisions, then, is that the economic burden on a fed-

[10] That the constitutional question under the intergovernmental tax immunity doctrine arises separately from the statutory exemption provided by Section 3124(a) is apparent from this Court's analysis in *Loewenstein*. After first addressing the Nebraska tax under Section 3124(a), and concluding that the statute did not apply, the Court addressed whether the tax was forestalled by the constitutional doctrine. *Loewenstein*, 513 U.S. at 135-37. *See also Rockford Life Ins.*, 482 U.S. at 188 ("[W]e shall first decide whether the statute requires that Ginnie Maes be exempted from state property taxes, and then consider whether the constitutional doctrine of intergovernmental tax immunity requires any broader exemption.").

> eral function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituent of the State.

County of Fresno, 429 U.S. at 462. The Ohio Supreme Court accepted that the franchise tax in Ohio taxes gains on dispositions of federal obligations and not state obligations. It nonetheless refused to apply the constitutional test by ruling that NACCO had not surmounted a relatively high evidentiary hurdle.[11] The barrier thus imposed contravenes this Court's precedents.

This Court has tailored the proofs required to invoke the intergovernmental tax immunity doctrine for two separate situations, one where the tax discriminates against those who deal with the federal government and the other where the tax is not discriminatory. Where discrimination is shown, the Court has adopted a virtual *per se* test. *See Smith v. Davis*, 323 U.S. at 117 (prohibiting discriminatory state taxes that burden Treasury obligations "in the slightest degree"); *Willcuts v. Bunn*, 282 U.S. 216, 229 (1931). By contrast, where the tax is not discriminatory, the challenger must establish that a federal governmental function or instrumentality is directly burdened or impaired. In this latter respect, in *Willcuts v. Bunn*, the Court referred to

> subjects which fall within the general application of nondiscriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government.

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[11] The Ohio Supreme Court held that NACCO had not shown that the federal government's functions had been adversely affected or impeded, Pet. App. 10a, and that the relationship of the federal government to the private sale of the Treasury bond in the secondary market was "too attenuated" to invalidate the Ohio franchise tax on the gain from the sale. Pet. App. 11a.

288 U.S. at 225. *See also Loewenstein*, 513 U.S. at 135-37; *Rockford Life Ins.*, 482 U.S. at 189-191; *County of Fresno*, 429 U.S. at 460.

In this case, the Ohio Supreme Court was addressing a discriminatory tax, yet it applied the evidentiary tests that have been employed in evaluating nondiscriminatory systems of taxation.

This distinction in evidentiary requirements between cases addressing discriminatory and evenhanded taxes has parallels in this Court's jurisprudence involving the dormant Commerce Clause. *Compare City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978) (applying a "virtually *per se* rule of invalidity" to laws that discriminate on their face), *with Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970) (requiring evenhanded law to be "upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits"). Another analog is found in this Court's decisions applying the Privileges and Immunities Clause. *See Toomer v. Witsell*, 334 U.S. 385, 396 (1948) (requiring, once discrimination against nonresidents is demonstrated, a "substantial reason for the discrimination beyond the mere fact that they are citizens of other States"). *See also Lunding v. Tax Appeals Tribunal of the State of New York*, No. 96-1462 (argued November 5, 1997).

The intergovernmental tax immunity doctrine is derived from several different parts of the U.S. Constitution—the Tax Clause, art. I, § 8, cl. 1, the Borrowing Clause, art. I, § 8, cl. 2, the Supremacy Clause, art. VI, cl. 2, and the structure of the Constitution relating to the roles of the federal government and of the States. *See McCulloch v. Maryland*, 4 Wheat (17 U.S.) at 425-436. Each of these elements has its place in shaping the doctrine. This case touches most directly on the Borrowing Clause, and certiorari should be granted to enable the Court to consider whether the decision of the Ohio Supreme Court has sub-

merged the import of that clause and thus has distorted the doctrine itself.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

PAUL SALTZMAN
SARAH M. STARKWEATHER
THE BOND MARKET ASSOCIATION
40 Broad Street
New York, NY 10004-2373

ERIKA W. NIJENHUIS
CLEARY, GOTTLIEB, STEEN & HAMILTON
One Liberty Plaza
New York, NY 10006-1470

December 24, 1997

CHARLES F. LETTOW
(Counsel of Record)
GIOVANNI P. PREZIOSO
ONNIG H. DOMBALAGIAN
ABBY F. RUDZIN
CLEARY, GOTTLIEB, STEEN & HAMILTON
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006-1801
(202) 974-1500
Counsel for The Bond Market Association as Amicus Curiae